

Chapter 15 – it's time to define COMI

| BY JOANNE COLLETT

Chapter 15, the United States' codification of the UNCITRAL Model on Cross Border Insolvency (the 'Model Law'), commenced operation by way of the broad revisions to Title 11 of the United States Code (the 'Bankruptcy Code') in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. The stated aim in the relevant House Report was to "provide greater legal certainty for trade and investment as well as to provide for the fair and efficient administration of cross-border insolvencies, which protects the interests of creditors and other interested parties, including the debtor..." (H.R. Rep. No. 109-31, 109th Cong., 1st Sess., 106 (2005)).

The Model Law, which is largely unchanged in Chapter 15 of the Bankruptcy Code, creates a framework for recognition of foreign proceedings. Two types of proceedings are recognised – the 'foreign main proceeding' and the 'foreign non-main proceeding,' and the rights and benefits given to a successful foreign petitioner depend on whether the insolvent company has either its 'centre of main interests' (COMI) or an 'establishment' in the United States.

In the recent case of *In re Fairfield Sentry Limited* (SDNY, 10-13164, Lifland J, 22 July 2010), the US Bankruptcy Court for the Southern District of New York considered steps taken by a liquidator of an offshore hedge fund in the liquidation of the insolvent company after the commencement of the local proceeding when determining whether or not to grant recognition.

The purpose of this article is to argue that this recent decision is both impractical and falls short of the stated aims of both the Model Law and Chapter 15, and that the better response to addressing the problem of determining COMI is reform of the Model Law by UNCITRAL (and corresponding legislative reform by the countries which have adopted it) to define the time at which COMI is to be assessed as the time immediately preceding commencement of the first insolvency proceeding which is ongoing in respect of the relevant company.

Chapter 15 provisions

Chapter 15 provides a powerful tool for foreign practitioners to administer the affairs of a debtor located outside the United States with assets, claims, business or other ties to the United States, without the need to commence a plenary bankruptcy case and incur the time and cost of doing so. Depending on the nature of its assets located in the United States, the commencement of a plenary case may be simply duplicative

and unnecessary.

There are various automatic benefits to the foreign insolvency practitioner in having the foreign proceeding recognised as a foreign main proceeding rather than a non-main proceeding, including *inter alia* the following: (i) the automatic stay in §362 of the Bankruptcy Code applies to property of the debtor which is within the territorial jurisdiction of the United States; (ii) the invalidity of post-petition transfers and security interests provided in §§549 and 552 are operative; and (iii) the foreign representative is empowered to operate the company's business and may exercise the rights and powers of a trustee under and to the extent provided by §§ 363 and 552. (Additional relief is also available to a foreign insolvency practitioner administering either a foreign main or non-main proceeding: 11 U.S.C §1521.)

As a result of the differences in the relief granted depending on whether the foreign proceeding is designated as a foreign main or non-main proceeding, and to fulfil the objective of certainty stated in the House Report, it is important that the test to determine what type of foreign proceeding will be recognised and in what circumstances is clear and unambiguous, particularly where such recognition is a precursor to the granting of relief which did not exist under the old §304 of the Bankruptcy Code. Furthermore, it is inappropriate that actions taken by foreign insolvency practitioners after the commencement of the foreign proceeding should be considered to determine COMI as this may lead to artificial manipulation.

The centre of main interests

The phrase 'centre of main interests', although critical to determine the type of foreign proceeding (if any) to be granted recognition, is not defined in the Model Law or Chapter 15. There is a presumption in §1516 that in the absence of evidence to the contrary, the company's registered office is presumed to be its COMI.

The UNCITRAL Guide to Enactment says only that the use of this phrase "corresponds to the formulation in article 3 of the European Union Convention on Insolvency Proceedings, thus building on the emerging harmonization as regards the notion of a 'main' proceeding". Pursuant to paragraph 13 of the preamble of Council Regulation (EC) 1346/2000 on Insolvency Proceedings, "the 'centre of main interests' should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable ►►

by third parties". In the leading case of *In Re Eurofood IFSC* [2006] 1 Ch 508 decided under the EC Insolvency Regulation, the European Court agreed (at [118]) that "the attributes of transparency and objective ascertainability are dominant". The test of "objective factors ascertainable to third parties" as formulated in the US case *In re SphinX Ltd* (2006) 351 BR 103 was held to be the appropriate test by the English High Court in the recent case *Stanford International Bank Ltd (In Receivership)* [2010] EWCA Civ 137.

Whatever criteria may ultimately be required to rebut the presumption that a company's COMI is its registered office, the goal must ultimately be to ensure that there is certainty in application which will protect the interests of creditors when dealing with companies with cross-border operations. Changes to business practices, location, functions, management and assets after the commencement of a foreign proceeding should not be taken into account when determining whether the presumption in §1516 is rebutted.

The rationale for an argument that COMI is to be determined as of the date of the commencement of the foreign proceeding is stated in *Re Eurofood* ([at 118]): "it is clearly essential that potential creditors should be able to ascertain in advance the legal system which would resolve any insolvency affecting their interests ... the relevant jurisdiction for determining the rights and remedies of creditors is clear to investors *at the time they make their investment*". (emphasis added) This is consistent with the Virgos Schmit Report on the Convention of Insolvency Proceedings, 3 May 1996 at [75] in which the rationale for the requirement that COMI be ascertainable by third parties was that international jurisdiction "be based on a place known to the debtor's potential creditors. This enables the legal risks which would have to be assumed in the case of insolvency to be calculated". In *Stanford International Bank* (at [54]), the Court articulated the concern in both *Re Eurofood* and the Virgos Schmit Report as being that "persons dealing with the debtor should be able to know before insolvency intervenes which system of law would govern the eventual insolvency of their counterparty".

When dealing with a company, a creditor is entitled to assume that its COMI would be determined by reference to information reasonably available to the creditor right up to the point of commencement of an insolvency proceeding. As was stated by the Grand Court of the Cayman Islands in the case *In the matter of Philadelphia Alternative Asset Fund Limited* (February 22, 2006), investors who had made a decision to invest in a Cayman Islands domiciled fund "would have a reasonable and legitimate expectation that, in the event a winding up was necessary, it would occur in the Cayman Islands under the applicable law here".

The Fairfield decision

The case *In re Fairfield Sentry Limited* concerned a fund based in the British Virgin Islands (BVI) for which its foreign liquidators were seeking Chapter 15 recognition. In this case, the petitioners argued that

COMI should be measured as of the date of the Chapter 15 petition. The objectors argued that COMI should include the period prior to and leading up to the filing of the Chapter 15 petition and that the Court should look at the activities of the company prior to liquidation. On the facts of this case, the Court held that the BVI proceedings should be granted recognition as a foreign main proceeding, largely based on the fact that the 'nerve centre' of the fund had been shifted to the BVI after the appointment of the liquidators.

In this case, the company had ceased doing business seven months before the BVI liquidation proceedings were commenced (and 18 months before the petition was filed), and the activities of the company were thereafter limited to activities connected to the winding up. After the appointment of the foreign insolvency practitioners, the majority of the shareholders, the members of the liquidation committee, board meetings, liquid assets, employees and offices were all located in BVI. Importantly, there was no evidence on the facts of 'COMI manipulation' or 'opportunistic shift'. The Court did note that the concept of measuring COMI at the time of the commencement of the foreign proceeding "leaves the door open for an untoward gaming of the proceedings" but did not find such a problem in the case.

For offshore foreign insolvency practitioners taking the usual steps to wind up a hedge fund with its registered office offshore, this case must surely be welcome news and appears to represent a change in the attitude of the New York Courts: the very things which were accepted by Lifland J in *Fairfield* to support the finding that COMI had moved, such as movement of bank accounts and cash from the US, were not considered by him in the 2007 *Bear Stearns* case to carry any weight in the COMI analysis.

There are a number of other US cases in which the time for determination of COMI has been discussed: in the case *In re Ran* 607 F.3d 1017 (5th Cir. Tex. 2010) involving an individual, the Court examined this question and held (at 1025) that the appropriate time for determination of COMI was the petition date, since the Court was concerned there not be a "meandering and never-ending inquiry into the debtor's past interests".

In the case *In Re Betcorp* 400 BR 266 (Bankr. D. Nev, 2009), the Court held that to determine COMI by reference to operational history was flawed. In the case *In Re British American Insurance Company Limited* 425 BR 884 (Bankr. S.D. Fla. 2010), it was held (at 910) that the relevant date for determination of COMI can be no earlier than the date the Chapter 15 petition was filed and that (at HN 20) "selecting the latest possible date for the COMI analysis is consistent with the aim of international uniformity stressed in *Ran* and *Betcorp*".

Unfortunately, these cases failed to consider, or perhaps were not asked to consider, a fixed point in time prior to the filing of the Chapter 15 petition at which COMI should be measured, such as the date of commencement of a foreign proceeding. If there were such a fixed time, ►►



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many of the concerns expressed, including the potential for a never ending inquiry, simply fall away.

Conclusion

The current authorities discussing the time at which COMI is to be measured have focused on the wording of Chapter 15 (which in this respect is identical to the Model Law) and on a fear that there may not be international uniformity if the date for determination is anything other than the date of the filing of the Chapter 15 petition. However, this narrow approach fails to consider the overriding goals of Chapter 15 and the Model Law (based on the EC Insolvency Regulation); namely that the COMI must correspond to the place where the company conducts

the administration of its interests on a regular basis and is therefore ascertainable to third parties when dealing with the company. A more appropriate time for COMI to be measured is the point in time immediately prior to the commencement of the original insolvency proceeding in respect of the company, as this is generally the last time at which creditors will have operational dealings with the company; and after which creditors may have their rights affected or impaired by acts of officeholders and local insolvency laws.

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